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18 MAR 1983

MEMORANDUM FOR: Chairman, National Intelligence Council

FROM:

 Director of Soviet Analysis

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SUBJECT: Comments on Reference Memo

REFERENCE: Memo to C/NIC from NIO at Large, Subject:  
The Controversy over "Soviet Defense  
Spending," dated 9 March 1983

1. I have read carefully Hans' memo and appreciate your sharing it with us. The two authors of the proposed IA on Soviet defense spending, together with the Deputy Division Chief of the Econometric Analysis Division, also have had a lengthy discussion with him to go over the points he raises. Basically, we are sympathetic with the main thrust of Hans' argument, namely that our constant 1970 ruble estimates do not pick up all the real costs associated with Soviet defense spending and do not reflect how the leadership views the burden. In our draft, we acknowledge these difficulties and, based on Hans' comments and others we have received, we plan to highlight these points even more, both in the text and in a methodological appendix to the paper.

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2. Nevertheless, despite these caveats, we remain convinced that our overall defense spending estimate does capture, admittedly in a rough fashion, the flow of resources going to defense. Nobody who has reviewed this paper within the Agency disputes our estimate that there has been a slowdown in the rate at which military hardware is being produced in physical terms. To simply assert, as Hans' does, that industrial bottlenecks and technical difficulties in developing more complex weaponry -- which the Soviets have always experienced -- has completely distorted relative prices in recent years and has led us to seriously underestimate costs, goes much too far. Other possible causes of the slowdown--for example, a policy decision to comply with the unratified SALT Treaty--would not produce this cost phenomenon. Further, there is evidence that some costs are

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lower. For instance, we know that computers (an area that has an important bearing on modern military weapons), have actively fallen as a result of the 1982 price reform.

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3. In this regard, we have a number of projects underway which should give us a much better understanding of the price issue in the next year or two. In particular, we hope to complete a project this year which could aid in moving our price base to a more recent year. We also have work under way -- mostly in the form of external contracts -- which will allow us for the first time to directly cost the Soviet R&D effort, although the payoff on this is probably more remote. So far, however, we have uncovered no evidence in these two projects that suggests we are grossly underestimating the Soviet commitment of resources to defense.

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4. Unless you raise further objections, we plan to go forward with the paper and will note on the title page that the paper has been discussed (not coordinated) with the National Intelligence Council.

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SUBJECT: Comments on Hans Heymann's Memo

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SOVA/PA:  (16 March 1983)

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